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Dear County and District Superintendents, County and District Chief Business Officials,
Charter School Administrators:

UPDATE ON AUDIT REFORM LEGISLATION

This letter is intended to provide an overview of the changes to audit related statutes with the passage of Assembly Bill (AB) 2834 (Migden), Chapter 1128, Statutes of 2002. This bill, effective January 1, 2003, withdraws the State Controller's Office's (SCO) audits of average daily attendance (ADA) and contains numerous amendments to the local education agency's (LEA) annual audit process, including changes to the appeal process. The seven major topics of the bill are outlined below.

Average Daily Attendance (ADA) Audits

- Audits performed using funds appropriated (\$3 million for each of the last three fiscal years) to the Department of Finance (DOF) to contract with the SCO to conduct ADA audits are withdrawn, with no loss of apportionment for any identified audit findings. Any audits in progress are discontinued. (*Education Code* Section 42238.75)
- In accordance with AB 2834, the SCO has notified LEAs that it is no longer necessary to retain records supporting pupil attendance and excused absences for the 1996-97 fiscal year. (*Education Code* Section 42238.75(c))

Auditors

- Currently, the SCO has the authority to conduct quality control reviews of independent auditors' working papers. Under this new legislation, however, the SCO must conduct a quality control review of the independent auditors' working papers for the prior three fiscal years if: 1) the LEA received an emergency apportionment, 2) the budget of the LEA was disapproved or the LEA received a negative certification on any budget or interim report, or 3) the responsible county superintendent of schools has determined that a lack of going concern exists for the LEA. (*Education Code* Section 14504.2)

- The SCO will establish a directory of certified public accountants or public accountants deemed as qualified to conduct audits, which will be published by the Controller not later than December 31 of each year. The criteria used to establish the list shall be based on the quality control reviews conducted by the Controller, and the good standing of the auditor as certified by the California Board of Accountancy. (*Education Code* Section 41020(f))
- Commencing with the 2003-04 fiscal year, a lead or coordinating audit partner having primary responsibility for conducting or reviewing an LEA audit may not provide audit services to an LEA for more than six consecutive years. The Education Audits Appeal Panel (EAAP) may waive this requirement if no other eligible auditor is available. The legislature may reconsider this statute upon release of a report by the Comptroller General of the United States addressing the mandatory rotation of public accounting firms. (*Education Code* Section 41020(f))
- Any non-auditing, management, or other consulting services provided to an LEA by an accounting firm while the firm is performing an audit of the agency must comply with the new auditor independence standards as established in Government Accounting Standards, Amendment #3, published by the United States General Accounting Office. (*Education Code* Section 41020(s))
- The county superintendent of schools must approve the audit contract between an audit firm and the LEA if the LEA received a disapproved budget or negative certification on any budget or interim financial report during the current or prior two years, or the county superintendent determined that a lack of going concern exists for the LEA. (*Education Code* Section 41020(b)(2))

Audit Guide

- In prior years, the SCO developed the annual Audit Guide in consultation with representatives from the DOF, the California Department of Education (CDE), the California Society of Certified Public Accountants, and county offices of education. Beginning with the 2002-03 fiscal year, the new legislation replaces the general representation from the county offices of education, with formal representation from the California County Superintendents Educational Services Association, and adds representation from the California School Boards Association, the California Association of School Business Officials, and the California Teachers Association. (*Education Code* Section 14502(a))
- Beginning with the 2003-04 fiscal year, the SCO, in consultation with the representatives noted above, will propose the content of the Audit Guide and submit it to the EAAP for review and possible amendment. The Audit Guide shall be adopted by EAAP pursuant to

the rulemaking procedures (emergency regulation process may be used) of the Administrative Procedures Act. It is the intent of the Legislature that beginning with the 2003-04 fiscal year, the Audit Guide be adopted by July 1 of the fiscal year to be audited. However, beginning with the 2004-05 fiscal year, the July 1 deadline *must* be met, not just attempted. In addition, a supplemental audit guide may be adopted by March 1 of the audit year to address any legislative changes to the conditions of apportionment (*Education Code* Section 14502.1)

Education Audits Appeal Panel (EAAP)

- Currently, the EAAP consists of the Superintendent of Public Instruction (SPI), the Director of the Department of Finance, and a Chief Administrative Officer of the Fiscal Crisis and Management Assistance Team, or one of their designees. The EAAP makes determinations on appeals of audit findings filed by LEAs. (*Education Code* Section 41344(d))
- AB 2834 establishes the EAAP as a separate state agency, consisting of the same members indicated above. The status as a separate state agency provides the authority to expend funds, hire staff, make contracts, sue and be sued, and issue regulations. The new agency will hire an executive officer who is responsible for the informal, summary appeals discussed below. (*Education Code* Section 41344.1)

Formal Appeals

LEAs may appeal an audit finding with the EAAP within 60 days of a final audit report. The EAAP refers the appeal to the Office of Administrative Hearings and an Administrative Law Judge (ALJ) will hear the case and prepare a proposed decision for the EAAP's consideration in making a final determination on the appeal. The EAAP may approve settlements and make findings of fact and interpretations of law; it may also determine that there has been compliance, substantial compliance, or that an instance of minor or inadvertent noncompliance constitutes substantial compliance. If the EAAP finds that there is substantial compliance, it may waive or reduce repayments by LEAs, or order other remedial measures to induce future compliance. (*Education Code* sections 41344.1 (b) and (c))

Informal, Summary Appeal

In addition to the formal appeal process described above, there is now a voluntary, informal, summary appeal process for audit exceptions where the LEA was in substantial compliance with the law. The informal, summary appeal must be made to the executive officer of the EAAP within 30 days of a final audit report. The executive officer may order reduced repayment and/or other remedial measures if it is determined that the LEA was in substantial compliance, and the

audit finding is less than 150 ADA or \$750,000. If an audit finding is more than 150 ADA or \$750,000, the executive officer may order reduced repayment and other remedial measures with the written approval of the DOF and the CDE. LEAs may file an informal, summary appeal concurrently with a formal appeal, or they may file a formal appeal within 30 days of receiving a final determination on the informal, summary appeal. (*Education Code* Section 41344.1 (d))

Repayment Plans

The timeline for requesting a repayment plan has changed. Prior to this legislation, repayment plans could be considered only if the requests were submitted within 90 days after receiving the final audit. This meant that if an LEA chose to appeal an audit finding, it also needed to request a repayment plan prior to knowing the final determination of its appeal. Under this new legislation, LEAs may also request a repayment plan within 30 days after receiving a final determination on an appeal, or within 30 days after receiving a determination of an informal, summary appeal. (*Education Code* Section 41344(a))

- Any LEA with an EAAP appeal pending on January 1, 2003, may file a request for an informal, summary appeal by March 3, 2003. (*Education Code* Section 41344.1(d)(4))

Minor and Inadvertent Waivers

- *Education Code* Section 41609 is repealed. This statute authorized the SPI, with the approval of the DOF, to grant waivers to LEAs if their noncompliance with statutes or regulations was minor and/or inadvertent.

County Superintendents' Review of Audit Findings

- Currently, county superintendents of schools are required to certify to the SPI, that all prior year audit findings for LEAs under their jurisdiction have been reviewed and corrected, or that an acceptable plan of correction has been submitted. The county superintendents of schools must now also make this same certification to the SCO. (*Education Code* Section 41020(k))
- Currently, county superintendents of schools identify attendance-related audit exceptions, and require LEAs to submit appropriate amended reporting forms to the CDE. The county superintendents must now also require LEAs to submit appropriate amended reporting forms to the CDE for any exception (not just attendance-related exceptions) involving state funds. (*Education Code* Section 41020(k))

Audits of Mandated Cost Claims

- In the past, the SCO performed audits of mandated cost claims within two calendar years after the reimbursement claim was filed. Under AB 2834, the SCO may initiate an audit of a mandated reimbursement claim no later than three years after the date that the actual reimbursement claim is filed or last amended. In addition, any ineligible reimbursement is now subject to an interest penalty. (*Government Code* Section 17558.5)

If you have any questions about this letter, or the audit process, please call our Audit Resolution Unit at (916) 323-8068. Please note that this memo is also available on the CDE website at [<http://www.cde.ca.gov/fiscal/audit>](http://www.cde.ca.gov/fiscal/audit).

The information contained in this letter is advisory only. LEAs are encouraged to review the actual laws that provide the basis for this memo and consult with their own legal counsel regarding the application of any of these issues to a specific situation.

Sincerely,

JACK O'CONNELL

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